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Personal Property Tax Reform

Positions and Recommendations Submitted to the June Special Session of the 51st Legislature

June 1989

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INTRODUCTION

The reform of Montana's personal property taxation is long overdue. Most people recognize that Montana's classification rates, which are as high as 16%, are out of line. We must bring our rates to a more competitive level. This is an absolutely essential ingredient for an improving economy. And critical areas such as adequate school funding ultimately depend upon a healthy economy, regardless of methods adopted to meet the current issue of equalization.

Personal property tax reform is not a partisan issue. Both gubernatorial candidates recognized the problem and, as a result, called for personal property tax reductions. However, some form of replacement revenue must be provided to local governments to compensate for the resultant revenue reductions, given these agencies' reliance on property tax revenues to fund local services. Selecting sources of replacement revenues requires difficult decisions.

I will submit a personal property tax reform proposal to the special session that will stand on its own merits. Replacement revenues are identified and proposed. I would hope that the Legislature will agree with me that the issue is of vital importance to the state's residents and worthy of the difficult decisions on how to replace revenues for local governments.

Previous legislatures have postponed these tough decisions long enough. We should not accept further delays. The time to act is now.

INITIAL PROPOSAL

Background and Proposed Changes

Montana's property tax system has evolved into a system that places an unacceptable burden on personal property. In the early 1970s Montana taxed land, buildings, and personal property equally; all property faced the same effective tax rate. However, after two reappraisals and compensating reductions in the classification rate for real property, and with no similar adjustments for the annually appraised personal property, the situation has changed so that personal property is currently taxed at a rate about four times higher than homes and Main Street businesses.

Similarly, tax rates faced by particular types of personal property now vary widely because property tax classes were added to provide tax relief to preferred properties.

Current effective Montana tax rates for personal property are now out of line with those imposed by other states; our average effective rate appears to be among the highest in the nation. As shown in Figure 1, the effective tax rate on personal property in Montana is four to five times that imposed by our neighbors.

High personal property tax rates impede investment in new and modernized equipment, the cornerstone of economic development. Since the creation of jobs and income is of utmost importance to the citizens of Montana, we must take steps to restore our competitive position with our neighbors and to restore and maintain balance in our property tax system. Such a change allows us to compete more successfully with other states for our fair share of the investments in plant and equipment necessary to create new jobs.

To accomplish this end, we propose an immediate reduction in the classification rate for all personal property currently taxed at a rate in excess of 7% (except that of utilities) to 7%. Replacement revenues for local governments are proposed so that this crucial change is not dependent on the enactment of a sales tax.

I am convinced that the proposed 7% rate does not go far enough. Therefore, I will support efforts to further reduce the rate during the special session provided acceptable replacement revenues can be identified. In any case, I intend to offer legislation to the next regular session to reduce further the tax rate on personal property to a uniform 4% level.

As shown in Figure 1, the move to a 7% tax rate will make our personal property taxes more competitive with those of our neighbors.

Figure 1

Effective Tax Rates on Personal Property - 1985

Montana	4.46%	— Current Law
	2.10%	— Proposed Rate*
Idaho	1.53	
Minnesota	Exempt	
North Dakota	Exempt	
South Dakota	Exempt	
Utah	1.48	
Washington	1.14	
Wyoming	0.89	

(Source: The Montana Taxpayer, May 1987, Montana Taxpayers Association)

* The proposed rate is calculated at 300 mills as a point of reference. The actual rate faced by a particular business will vary with local mill levies.

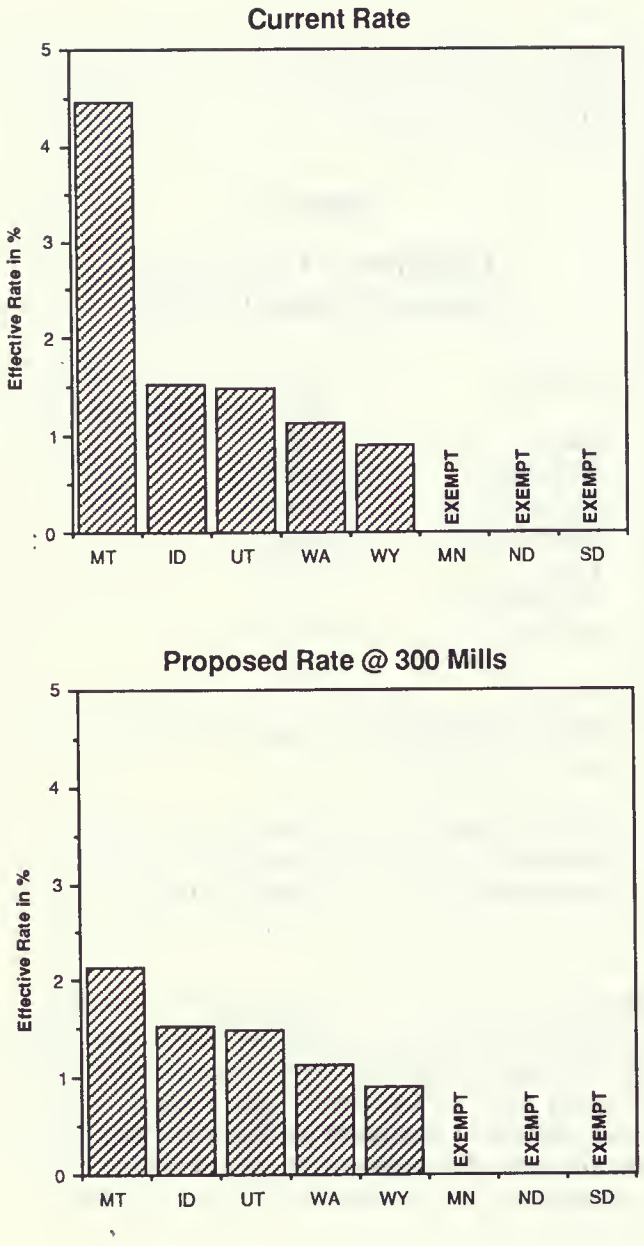
Figure 2 provides a graphic comparison of Montana's effective rate on personal property with rates imposed by our neighboring states. Effective tax rates, defined as property taxes as a percent of the property's market value, provide a consistent yardstick to compare rates among states. For instance, the 7% rate being proposed translates into a 2.1% effective tax rate at 300 mills.

Businesses Affected and Dollar Distribution

The proposed reduction in personal property taxes will affect virtually every business operating in the state. Overall, the proposal will reduce the cost of doing business by about $25.5 million annually.

The bulk of these savings affects the state's major economic sectors. For example, the state's 25,000 farmers and ranchers are projected to realize cost savings of roughly $4.6 million, or about 20% of the total tax relief.

Figure 2



The mining industry's taxes on mining machinery and equipment are projected to fall by at least $1.6 million. And the state's manufacturers will face reduced tax costs of about $7.7 million on their equipment and supplies. Finally, taxes on furniture and fixtures, the bulk of which is owned by Main Street businesses, will experience a $7.0 million reduction.

Taken together, these industries, the health of which is crucial for the attraction and retention of jobs in the state, will receive $20.9 million, or over 80% of the tax relief granted by the proposal.

Figure 3 provides estimates of the tax savings by major property type.

Figure 3

Estimated Tax Relief from 7% Personal Property Tax Rate by Major Property Type

Property Type	Total Change in Taxes Levied
Agricultural Property:	
Ag Implements	(4,602,664)
Mining Property:	
Oil Field Equipment	(1,141,593)
Mining Machinery	(126,794)
Coal and Ore Haulers	(311,262)
Manufacturing Property:	
Manufacturing Machinery	(7,117,114)
Supplies and Materials	(610,381)
Retail and Service Sector:	
Ski Lifts	(39,761)
Machinery other than Farm, Mining, Manufacturing	(1,998,374)
Rental Equipment	(201,107)
Furniture and Fixtures	(6,959,147)
CB's and Mobile Phones	(22,539)
Cable TV Systems	(332,791)
Theatre and Sound Equipment	(23,568)
Radio and TV Broadcasting Equipment	(220,723)
All Other Property	(25,636)
Motor Vehicles:	
Watercraft, ATV Back Taxes	(110,098)
Trucks, Buses and Trailers	(1,684,229)
STATE TOTAL	(25,527,781)

<u>Economic Impact</u>

The proposed reduction in personal property taxes will make Montana a more attractive place to do business. It will improve our ability to market the state's unique economic advantages and to attract new jobs.

REPLACEMENT REVENUES, IMPACTS

Replacement Revenues

Local governments in Montana are heavily dependent on property taxes for funding of the services they provide. Unless replacement revenues are provided to compensate for the reduction in personal property taxes, local services will be reduced or the property tax burden will be shifted to other property taxpayers.

We propose the following tax measures to provide reimbursement revenues for local governments and the school system tax base:

- **Revise Taxation of Coal** — We propose replacing the coal severance tax with a comparable privilege tax which will generate the same amount of revenue. This change will allow revisions of the tax allocation to delete the allocation to the coal tax permanent trust, thereby effectively capping the trust. With this change, we will be able to spend net revenues (net of the loss of interest earnings) of $22 million. A general fund appropriation of $16 million will reimburse local governments for that portion of the revenue losses created by the proposal.

  Capping the coal tax trust will not affect the volume of loans for in-state investment since these loans are backed by the principal of the trust. No bonds are guaranteed by the trust, so the proposal will not affect the state's bond issues or rating. Shortfalls in water development bond repayments are serviced by the account, but money diverted to the general fund will cover this amount ($600,000 budgeted).

- **Raise Video Poker Tax** — We propose revising the tax rate on the net income from video gaming machines from the present 15% rate to 25%. This increase will raise approximately $8 million per year in reimbursement revenues.

- **Impact on Income Tax**—With personal property tax reductions, businesses will become more profitable. Net taxable income will increase initially due to reduced deductions by taxpayers for personal property taxes paid. This impact on income taxes is estimated to provide $2 million annually in offsetting revenue.

Collectively, these revenue measures will provide the necessary revenues — $26 million annually — to allow the full reimbursement of local government and state foundation program revenue losses due to the proposal.

Long Term Impact of the Proposal

The proposed personal property tax reductions will make our tax more competitive with those of our neighboring states and the nation. Further, the proposal offers a real reduction in the cost of doing business in the state. The reduction in operating costs reduces the fixed costs of operating a business — costs incurred regardless of production level — thereby aiding in the retention of existing, marginally profitable businesses by increasing their profits. The proposal, therefore, will result in greater retention of existing businesses and the attraction of more new businesses to the state. This will increase the employment prospects of the state's residents.

As the amount of investment subject to tax grows at a faster rate than would occur under current law, local governments also will, in the long run, benefit from the reduced taxes on personal property. This growth, coupled with the reimbursement described above, will result in greater total local government revenues.

Coal Tax Trust

The proposed use of the coal tax is equivalent to capping the trust. Its use was recognized by both political parties in last year's campaign as a potential revenue source related to economic development. The proposed use of this revenue for personal property tax relief is in keeping with this philosophy.

In addition to the use of this money for personal property tax relief, I will propose in separate legislation a 2% one-time increase in the school foundation program schedules for FY89-90. This will bridge the gap to a new equalization program and would be funded with the additional $6 million from the coal tax stream during FY90.

In years beyond FY 90 the coal severance tax rate is scheduled to drop to 15%, reducing somewhat the available revenue from the diversion. I will not attempt to prevent this scheduled reduction. We are comfortable that sufficient personal property tax reimbursement revenue will be available into the future to offset this specific proposed reduction, even with the scheduled rate decline.

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